In the Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-159

FIRST NATIONAL BANK IN PALM BEACH AND PHILLIP D. O'CONNELL, CO-TRUSTEES OF A TRUST CREATED BY THE WILL OF MICHAEL A. KELLY, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the district court (Pet. App. 34-44) is not reported. The opinion of the court of appeals (Pet. App. 17-33) is reported at 443 F. 2d 480.

JURISDICTION

The judgment of the court of appeals was entered on May 7, 1971 (Pet. App. 17-33). The petition for

a writ of certiorari was filed on August 3, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a charitable remainder interest in a trust created by the decedent qualified for federal estate tax deduction under Section 2055 of the Internal Revenue Code of 1954 (prior to its amendment by the Tax Reform Act of 1969) and the applicable Treasury Regulations, notwithstanding the trustees' unrestricted discretionary powers to invade corpus for the benefit of the income beneficiary.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of Section 2055(a) of the Internal Revenue Code of 1954 and Section 20.2055-2 of the Treasury Regulations on Estate Tax (1954 Code) are set forth in the Appendix, *infra*, pp. 9-12.

STATEMENT

Decedent died testate on February 4, 1961. His will established a trust under which income was to be paid to his sister for her lifetime, with the remainder to a qualified charity. (Pet. App. 20, 35-36.)

The will granted the following powers to the trustees, "[i]n addition to the powers, authorities, discretions and immunities" given them by law: (1) they were authorized to invest and reinvest the trust

corpus in "any form of investment which they, in their sole and absolute discretion, shall determine" without regard to state law governing trust investments and without liability for "loss of principal or income occasioned by any such investment"; (2) they were empowered to "[d]etermine, in any case where doubt exists under the facts or applicable law, whether any charges, expenses or disbursements * * * shall be charged against the principal or income * * * of the trust," their determination in that regard being "conclusive and binding upon * * * said trusts and upon all persons interested therein"; (3) they were given discretion to apportion any "extraordinary dividends payable in any stock or other securities, and also any *liquidating dividends*" between the income and corpus of the trust; finally, (4) the trustees were separately authorized to purchase bonds and securities at a premium and were specifically directed not to amortize that premium. (Pet. App. 21-23, 36-37.)

The estate included the value of the trust property in decedent's gross estate as required, and claimed a charitable deduction for the discounted value of the remainder interest under Section 2055 of the Internal Revenue Code of 1954, Appendix, *infra*, p. 9. The Commissioner disallowed the deduction, and the estate, after paying the tax in dispute, brought this suit for refund. The district court upheld the estate's claim, holding that, while the trustees' power to apportion liquidating dividends to the income beneficiary theoretically empowered them

to deplete the remainder interest, state fiduciary law proscribed such a use of the power. (Pet. App. 41-44.) The court of appeals reversed, holding that Florida law governing the conduct of fiduciaries did not prohibit the trustees from exercising the powers granted them. Since the trustees' exercise of the powers would result in the diversion of corpus to the non-charitable income beneficiary, the court concluded that the remainder interest was not "presently ascertainable" within the meaning of Section 20.2055-2(a) of the Treasury Regulations, Appendix, *infra*, pp. 9-10, and therefore that the estate was not entitled to a charitable deduction. (Pet. 10-14.)

ARGUMENT

The decision below is correct. There is no conflict or any other reason for further review. Moreover, the issue turns in large part upon state law (here Florida) governing fiduciary conduct, and its importance has been diminished for the future by amendments to Section 2055 of the 1954 Code enacted by the Tax Reform Act of 1969.

1. This case raises essentially the same question as *Estate of Stewart* v. *Commissioner*, 436 F. 2d 1281 (C.A. 3), certiorari denied, October 12, 1971, No. 70-236, this Term. In our brief in opposition in that case, a copy of which we are serving on counsel for petitioners herein, we set out in full detail the law applicable to charitable remainder bequests. It is enough to reiterate here that a charitable remainder interest is not deductible unless it is "presently ascertainable, and hence severable from the non-

charitable interest" (Treasury Regulation 20.2055-2 (a)), *i.e.*, measurable by an objective standard "fixed in fact and capable of being stated in definite terms of money" (*Ithaca Trust Co.* v. *United States*, 279 U.S. 151, 154; *Merchants Bank* v. *Commissioner*, 320 U.S. 256; *Henslee* v. *Union Planters Bank*, 335 U.S. 595). Here, as in *Stewart*, the charitable remainder interest fails to meet this standard. As the court below held, the trustees were expressly given powers which, when exercised, would deplete trust corpus, and the fiduciary law of Florida did not prevent the use of these powers.

2. The approach taken by the Fifth Circuit here is the same as that employed by every appellate court which has recently considered this issue. In each instance the court has determined whether powers granted a trustee were of invasionary dimensions and, if so, whether state law would permit the trustee to use the powers granted. If, under state fiduciary law, a trustee could not exercise the invasionary powers granted him, a deduction has been permitted. If, on the other hand, the trustee could exercise the invasionary powers without violating his fiduciary duties, the deduction has been denied. There is thus no conflict in the circuits; each case turns upon the particular powers granted the fiduciary and upon local law. Compare *Peoples Trust Co. of Bergen County* v. *United States*, 444 F. 2d 193 (C.A. 3); and *Greer* v. *United States*, 71-2 U.S.T.C., par. 12,805 (C.A. 4), decided September 1, 1971; with *Estate of Stewart* v. *Commissioner*, *supra*; *Florida Bank at Lakeland* v. *United States*, 443 F. 2d 467 (C.A. 5);

Miami Beach First National Bank v. *United States*, 443 F. 2d 475 (C.A. 5), taxpayer's petition for a writ of certiorari pending, No. 71-350, this Term; and *Rand* v. *United States*, 71-2 U.S.T.C., par. 12,797 (C.A. 2), decided July 22, 1971.

This uniform approach was employed by the Third Circuit in *Peoples Trust Co. of Bergen County* v. *United States*, *supra*, with which petitioners assert conflict (Pet. 12-13). In that case, the trustee was empowered to invest in shares of mutual funds, and directed to pay capital gains distributions to the non-charitable income beneficiary. But the Third Circuit held that, in the absence of the settlor's clearly expressed intention to favor the non-charitable income beneficiary, New Jersey law would prohibit the trustee from using its discretionary power to prefer that beneficiary over the charitable remainderman.

Greer v. *United States*, *supra*, decided by the Fourth Circuit on September 1, 1971 (after the filing of the petition in the instant case), follows the established pattern. The court there reasoned that since the trustee was given limited power to invade corpus for the benefit of the non-charitable income beneficiary, and since that power was exercisable by reference to an admittedly ascertainable standard, North Carolina law would bar the trustee from exercising its administrative powers to deplete corpus to any extent beyond that required to meet the ascertainable standard.[1]

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[1] Petitioners also claim conflict with *Old Colony Trust Co.* v. *United States*, 423 F. 2d 601 (C.A. 1), and with *Ithaca*

3. Finally, as elaborated in our brief in opposition (p. 13) in *Estate of Stewart* v. *Commissioner*, *supra*, the question presented here has been mooted for the future by the recent amendments to Section 2055 enacted in the Tax Reform Act of 1969, P.L. 91-172, 83 Stat. 487, 560.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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Trust Co. v. *United States*, *supra* (Pet. 11-12, 14-15). The same contentions were made by the petitioner in *Estate of Stewart* v. *Commissioner*, *supra*. We dealt with those contentions in our brief in opposition in that case, on which we here rely (pp. 7-10, 12-13).

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 2055. TRANSFERS FOR PUBLIC, CHARITABLE, AND RELIGIOUS USES.

(a) *In General.*—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers (including the interest which falls into any such bequest, legacy, devise, or transfer as a result of an irrevocable disclaimer of a bequest, legacy, devise, transfer, or power, if the disclaimer is made before the date prescribed for the filing of the estate tax return)—

* * * *

(3) to a trustee or trustees, or a fraternal society, order, or association operating under the lodge system, but only if such contributions or gifts are to be used by such trustee or trustees, or by such fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no substantial part of the activities of such trustee or trustees, or of such fraternal society, order, or association, is carrying on propaganda, or otherwise attempting, to influence legislation, and such trustee or trustees, or such fraternal society, order, or association, does not participate in, or intervene in (including the publishing or distributing of

statements), any political campaign on behalf of any candidate for public office; * * *

* * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

SEC. 20.2055-2 *Transfers not exclusively for charitable purposes.*

(a) *Remainders and similar interests.* If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest. The present value of a remainder or other deferred payment to be made for a charitable purpose is to be determined in accordance with the rules stated in § 20.2031-7. Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years, and then to pay the principal to a charitable organization, the present value of the remainder is deductible. To determine the present value of such remainder use the appropriate factor from column 4 of Table I or Table II of § 20.2031-7, whichever is applicable. If the interest transferred is such that its value is to be determined by a special computation (see paragraph (e) of § 20.2031-7), a request for a specific factor, accompanied by a statement of the date of birth of each person the duration of whose life may affect the value of the remainder, and by copies of the relevant instruments, may be submitted by the executor to the Commissioner who may, if conditions permit, supply the factor requested.

If the Commissioner does not furnish the factor, the claim for deduction must be supported by a full statement of the computation of the present value made in accordance with the principles set forth in the applicable paragraph of § 20.2031-7.

(b) *Transfers subject to a condition or a power.* If, as of the date of a decedent's death, a transfer for charitable purposes is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that the charitable transfer will not become effective is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of a decedent's death and the estate or interest would be defeated by the performance of some act or the happening of some event, the occurrence of which appeared to have been highly improbable at the time of the decedent's death, the deduction is allowable. If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, the deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of the power. The deduction is not allowed in the case of a transfer in trust conveying to charity a present interest in income if by reason of all the conditions and circumstances surrounding the transfer it appears that the charity may not receive the beneficial enjoyment of the interest. For

example, assume that assets placed in trust by the decedent consist of stock in a corporation the fiscal policies of which are controlled by the decedent and his family, that the trustees and remaindermen are likewise members of the decedent's family, and that the governing instrument contains no adequate guarantee of the requisite income to the charitable organization. Under such circumstances, no deduction will be allowed. Similarly, if the trustees are not members of the decedent's family but have no power to sell or otherwise dispose of the closely held stock, or otherwise insure the requisite enjoyment of income to the charitable organization, no deduction will be allowed.

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